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The Double Dip…Debate

Plus: Does Personal/Enterprise Goodwill Factor into the Analysis?

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Connecticut AAML Webinar
Monday, May 2, 2022

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Karolina Calhoun, Vice President at Mercer Capital, has been involved with hundreds of valuation and litigation support engagements in a diverse range of industries on local, national and international levels. Prior to joining Mercer Capital, Karolina was a Senior Auditor at EY (Ernst & Young) in their Audit and Assurance Services practice.

As a member of Mercer Capital's Litigation Group, she provides valuation and forensics services for family law, gift & estate planning, commercial litigation, transactions (M&A), and further matters related to privately held businesses, dissenting shareholders, intellectual property, personal goodwill, etc. With her forensics accreditation, she provides economic and financial damages studies, asset tracing, lost profits, and lifestyle analyses.

Karolina served as the 2020 and the 2021 Valuation Chair of the AICPA's Forensic and Valuation Services Conference and is a member of the AICPA's CFF Exam Writing Task Force. In 2018, she received the Forensic and Valuation Services (FVS) Standing Ovation award, presented by the AICPA to professionals for significant contributions in their specialty areas and in their communities. Karolina served as the President of the Memphis Chapter of TSCPAs (2019-2020).

In February 2022, Karolina was invited and admitted to the American Academy of Matrimonial Lawyers (AAML) Foundation, Forensic and Business Valuation Division, a division of the AAML. In addition, she has been appointed to the AICPA Business Valuations Committee for the 2022-2023 volunteer service year.

Disclaimer!

- The opinions set forth in this presentation and discussion are for educational and discussion purposes.
- Matters vary based on underlying facts and circumstances and are evaluated as such. Comments and content presented herein are not absolute.
- Statues & precedent differ by state.

Session Overview

Particularly when the marital estate includes a business asset, subject to a valuation, the topic of double counting must be considered. Is the same income stream which is creating a valued asset on the marital balance sheet also being used for income determination for support? Or, has compensation and business earnings properly been allocated to the asset and to the income?

Further, what if there is a carve out to personal goodwill – how, if at all, does this impact the asset division as well as the income basis for support?

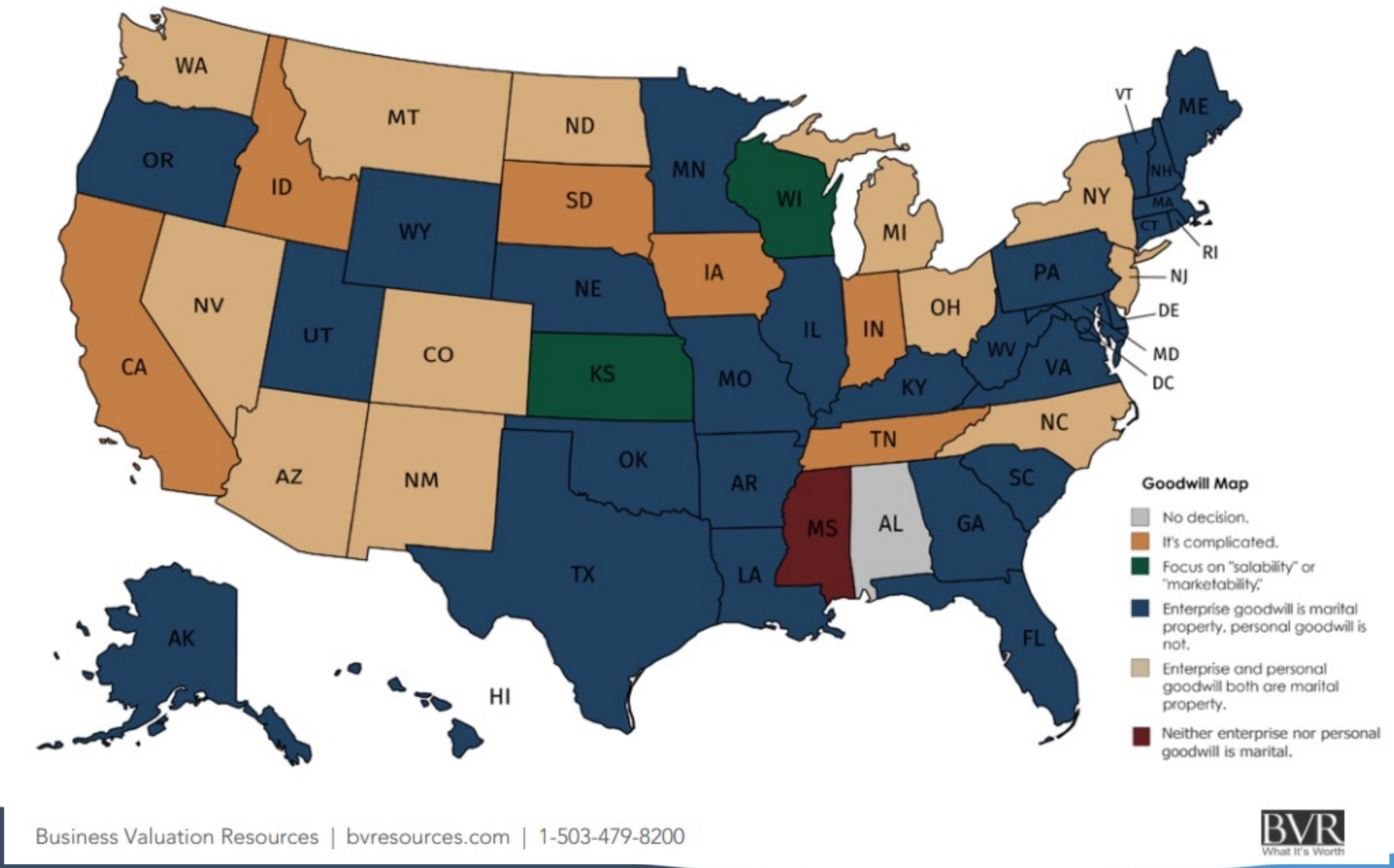
Personal vs Enterprise Goodwill

This is NOT a session on Personal vs Enterprise Goodwill, as that is a complex topic worthy of a lengthy presentation and slides.

But, the following slides highlight the importance and the key characteristics of each.

Often, this is one of the areas where experts (or clients!) disagree.

Why Is Personal vs Enterprise Goodwill Important?



Enterprise Goodwill versus Personal Goodwill

Enterprise goodwill generally is interpreted as representing value that is owned and/ or that has been created by an enterprise and that can be transferred. Identifiable intangible assets typically classified within the enterprise goodwill category include the following:

1. Trademarks and trade names
2. Patented and unpatented technology
3. Copyrights
4. Customer lists and relationships (patient files/records)
5. Contracts (employment, noncompete agreements)
6. Phone number
7. Leasehold
8. Trained and assembled workforce
9. Location

Personal goodwill generally is interpreted as representing attributes, that are unique to, and inseparable from, an individual. Attributes typically classified within the personal goodwill category include the following:

1. Personality
2. Reputation
3. Personal skill, expertise and knowledge
4. Personal relationships

In essence, personal goodwill is represented by certain attributes that are deemed to be incorporated into the very being of an individual, and, therefore, are unable to be sold or transferred to another individual.

Business Valuation Adjustments for Compensation

- **Owner Compensation**
    - How paid?
    - What roles & responsibilities?
    - Market rate?
    - Perquisites?
    - Others, example: rent expense if related-party entities – FMV?
    - ….. “True Income”
- **Income determination**
    - Adjusted income from compensation adjustment
        - i.e. ‘market compensation’
    - Used for alimony and child support determination

Beware of the Double Dip

- **Adjusted Owner Compensation in Business Valuation**
  - Basis for alimony and child support
  - Beware of the double count:
    - Earnings of the business used to create *value* of business asset vs.
    - Owner compensation reflected in expenses of the business

- **Property assets on balance sheet**
  - Rental income
  - Pass-through income
  - *Do not double count as an asset and income*

Oudheusden v Oudheusden

Holdings: The Supreme Court, D'Auria, J., held that:

trial court failed to consider all of the required statutory factors when it awarded wife permanent and nonmodifiable alimony, and

trial court did not improperly "double count" the value of husband's two closely held businesses while also considering husband's income from those businesses when awarding wife alimony.

Affirmed in part and reversed in part.

Also presented in this appeal is the question of whether the trial court, in its financial orders, equitably divided the marital estate or, instead, inappropriately engaged in "double counting" by awarding the plaintiff half of the value of the defendant's businesses among its orders dividing the marital property, while also awarding the plaintiff alimony on the basis of income generated by those businesses, which made up the defendant's sole sources of income. Because the issue of double counting is likely to reoccur on remand, and because we have not provided sufficient guidance concerning what constitutes double counting in contexts ***764** beyond those specifically implicated in our own case law, we reach this issue and agree with the plaintiff that this court's rule against double counting does not apply when, as in the present case, the asset at issue is the value of a business. Accordingly, we affirm in part and reverse in part the judgment of the Appellate Court.

We granted the plaintiff's petition for certification, limited to the following issues: (1) "Did the Appellate Court correctly conclude that the trial court had erroneously engaged in 'double dipping' by awarding the plaintiff alimony from income generated by the defendant's businesses and also awarding the plaintiff a percentage of those businesses in its division of property?" And (2) "[d]id the Appellate Court correctly conclude that the trial court had abused its discretion by failing to ***768** enter financial orders that equitably divided the marital estate?" *Oudheusden* v. *Oudheusden*, 332 Conn. 911, 912, 209 A.3d 1232 (2019). Additional facts will be set forth as required.

Oudheusden v Oudheusden

- $904,000 combined fair market value of the businesses
  - 50% = $452,000
- The adjustments also accounted for the "reasonable compensation payable to [the defendant] for the part-time services he provides to the company."
- In his excess earnings valuation, which calculates fair market value partly by considering the **610 businesses' goodwill, Guberman found that goodwill accounts for 81% of the overall value of Connecticut Computer & Consulting Company, Inc., and 49% of the value of WriteResult, LLC. *[As this reads, it appears to be all enterprise goodwill as no delineation of separate anywhere. Meaning the intangible value of the business over the tangible value.]*
- Alimony set at $18,000 per month, or $216,000 annually. The trial court did not explain how it came to this number but presumably it considered the appropriate statutory factors, *780 including the defendant's gross annual income, which the trial court found to be $550,000.

Oudheusden v Oudheusden

- The plaintiff argues that double counting did not occur here, because, according to our case law, double counting can occur only when a party is ordered to pay alimony from an income stream he or she no longer has because it was distributed in the division of property orders, not when, as here, the
- trial court distributes a **611 portion of the value of the businesses to the plaintiff while the defendant retains 100% ownership of those businesses. Because the defendant retains full ownership of the businesses, the plaintiff argues, he still has an <u>income stream from which to make the alimony payments that is separate and distinct from the payment made to the plaintiff in the property distribution.</u>
- We conclude that the trial court did not improperly double count the value of the defendant's businesses in the present case because any rule against double counting does not apply when **the distributed asset is the value of a business and the alimony is based on income earned from that business**.

Oudheusden v Oudheusden

What we don’t know per the case write-up:

- Did the Court ONLY use the compensation expensed within the businesses, or did the Court also use the earnings of the business which comprise the value of the asset?
    - i.e. What amount of ‘income’ i.e., compensation adjustment is used within the value of the businesses vs. what amount of ‘income’ the Court used?
- What about the goodwill?
    - Appears to be all enterprise goodwill = all marital

Further Considerations – generally speaking

- **Other Double Dipping**
    - Retirement accounts and other financial instruments/accounts
- **Pay & Need Analysis over remaining life expectancy of both divorcing parties**
    - Build in assumption for hypothetical future sale of business?
    - Lots of assumptions but can assist in many ways
- **Enterprise vs Personal Goodwill …**
    - Marital vs. Separate – included in the division?
        - Depending on if yes or if no … how to consider in income basis...?

Implications on Pay & Need Analysis

- Beyond the division of the marital estate, is there still a 1) need and 2) ability?
  - If Yes:
    - Constructing the pay & need analysis pulls together the division of the net assets at divorce date, future income and in turn, net cash available after taxes, and future expenses …
    - What about the earnings of the business (used in asset value) vs. compensation?
    - What if personal goodwill is concluded upon – how is it treated in division and then in the income analysis?
    - What is the level of ongoing income and how was it calculated (average, most recent, etc)?
    - What about the ultimate proceeds from the sale of a business?
    - What about the gains on investment vehicles?
    - What about retirement age?

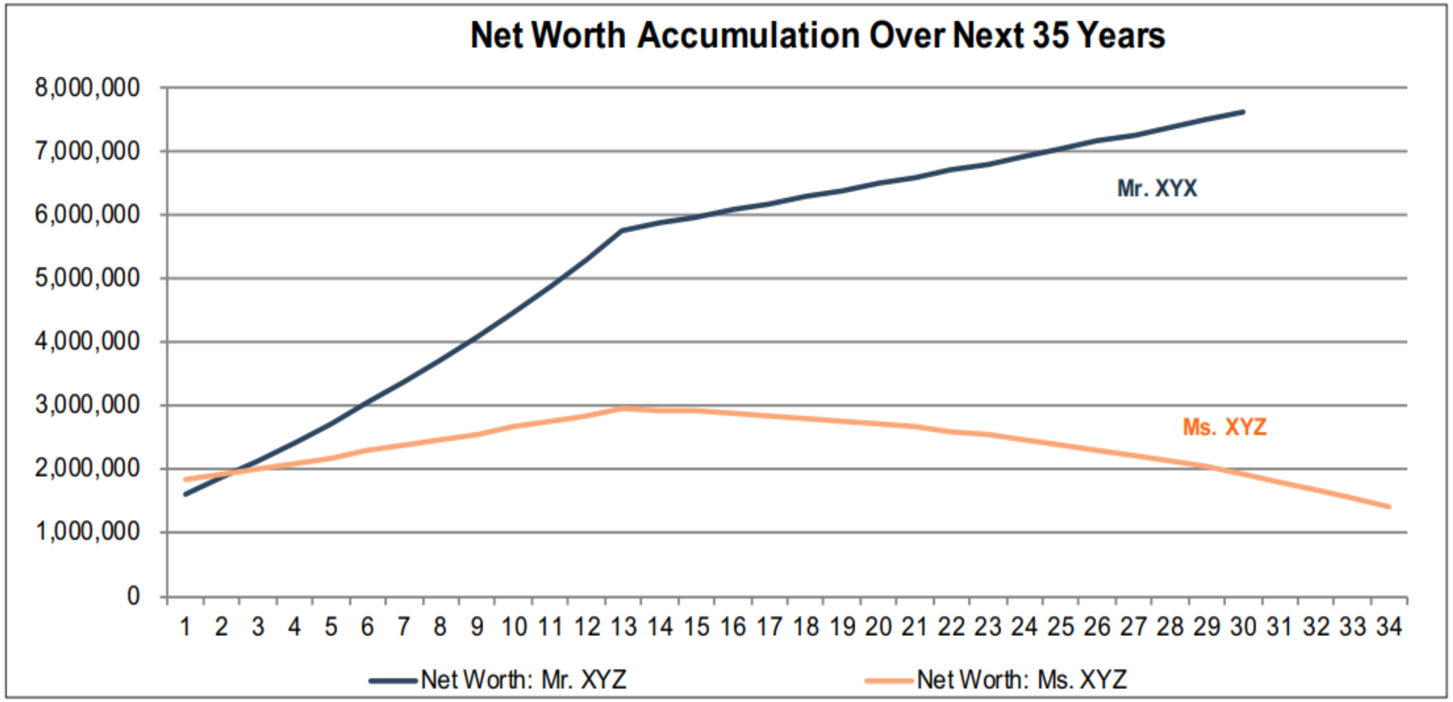
      …

      …

This analysis MUST be customized to the facts and circumstances of the matter at hand. If done well, the analysis operates much like a Net Worth Analysis – both at a point in time AND over time.

Sample Net Worth Analysis of the Pay & Need Analysis

Figure 2: Net Worth Accumulation Analysis



Note: **this chart takes MANY steps to get to – this is an output of the moving net worth over the remaining life of the divorcing parties.**

Example 1: Market Compensation Adjustment in Valuation

Income Statements	Last 12 mos. 6/30/2021	For the Fiscal Years Ended December 31 2020	2019	2018	2017	2016
Reported Net Sales	$41,999,781	$39,007,602	$44,301,604	$34,417,718	$22,687,216	$20,640,890
Adjustment: None	0	0	0	0	0	0
Adjusted Net Sales	41,999,781	39,007,602	44,301,604	34,417,718	22,687,216	20,640,890
Reported Cost of Sales	23,993,016	19,761,572	22,469,139	17,555,969	10,600,590	8,995,937
Adjustment: None	0	0	0	0	0	0
Adjusted Cost of Sales	23,993,016	19,761,572	22,469,139	17,555,969	10,600,590	8,995,937
Adjusted Gross Profit	18,006,765	19,246,030	21,832,465	16,861,749	12,086,626	11,644,953
Reported Operating Expense	15,375,156	16,427,151	16,972,870	14,814,354	11,589,230	10,913,857
Adjustment (1): Normalize Travel and Entertainment Expense	100,000	100,000	0	0	0	0
Adjustment (2): Normalize Vehicle Expense	100,000	100,000	0	0	0	0
Adjustment (3): Normalize Compensation for Flowthrough Taxes	0	0	(4,449)	(7,175)	(355,832)	(437,787)
Adjustment (4): Normalize Compensation - Distribution of Earnings	229,519	147,234	(255,542)	(557,162)	8,164	(51,637)
Adjusted Operating Expense	15,804,675	16,774,385	16,712,879	14,250,017	11,241,562	10,424,433
Adjusted Operating Income	2,202,090	2,471,645	5,119,586	2,611,732	845,064	1,220,520
Reported Other Income/(Expense)	(259,401)	(284,682)	(652,433)	(212,615)	(79,912)	(147,879)
Adjustment (5): Remove Gain/(Loss) on Disposal of Assets	7,551	25,702	1,019	11,261	(11,363)	0
Adjusted Other Income/(Expense)	(251,850)	(258,980)	(651,414)	(201,354)	(91,275)	(147,879)
Adjusted Pre-Tax Income	$1,950,240	$2,212,665	$4,468,172	$2,410,378	$753,789	$1,072,641

Example 1: Market Compensation Adjustment in Valuation

	For the Fiscal Years Ended December 31				
Provided by Management - Owner Comp & Profit Sharing	**2020**	**2019**	**2018**	**2017**	**2016**
Total Compensation of Owners/Officers					
President - Annual Salary	$265,000	$260,000	$260,000	$260,000	$273,844
President - Non-Salary Compensation	678,391	495,213	797,752	458,566	680,000
President - Total CompensationIncludes Distribution for Company's Taxes	**$943,391**	**$755,213**	**$1,057,752**	**$718,566**	**$953,844**
1040 Tax Due - Paid to Brubaker for Flow-through Owner Payment of Taxes	524,813	4,449	7,175	355,832	437,787
President - Total CompensationNet of Distribution for Taxes	**$418,578**	**$750,764**	**$1,050,577**	**$362,734**	**$516,057**
VP Sales & Operations - Annual Salary	$203,846	$203,072	$203,072	$203,000	$185,115
VP Sales & Operations - Non-Salary Compensation	303,051	520,000	250,000	50,000	250,000
VP Sales & Operations - Total Compensation	**$506,897**	**$723,072**	**$453,072**	**$253,000**	**$435,115**
Summary:	45.23%	50.94%	69.87%	58.91%	
President - Total Compensation, Net of Distribution for Taxes	**$418,578**	**$750,764**	**$1,050,577**	**$362,734**	**$516,057**
VP Sales & Operations - Total Compensation	**506,897**	**723,072**	**453,072**	**253,000**	**435,115**
Total Compensation of Owners/Officers, Net of Distributions for Taxes	**$925,475**	**$1,473,836**	**$1,503,649**	**$615,734**	**$951,172**

...

Total Compensation of Owners/Officers, Net of Distributions for Taxes	$925,475	$925,475	$1,473,836	$1,503,649	$615,734	$516,057
Adj. for Distributed Earnings to Estimate Owner/Officer Market Com	**$229,519**	**$147,234**	**($255,542)**	**($557,162)**	**$8,164**	**($51,637)**

Example 1: Market Compensation Adjustment in Valuation

Determination of Market Compensation of Owner(s)/Officer(s)	Last 12 mos. 6/30/2021	For the Fiscal Years Ended December 31 2020	2019	2018	2017	2016
Note - Adjusted Gross Compensation of President, Divorcing Spouse						
Total Compensation, net of distribution for taxes		$418,578	$750,764	$1,050,577	$362,734	$516,057
Adjustment for Distributed Earnings (70/30 Distribution Agmt)	70%	103,064	(178,879)	(390,013)	5,715	(36,146)
Adjusted Gross Compensation		$521,642	$571,885	$660,564	$368,449	$479,911

Compensation of Business Owner Divorcing Spouse.

- Earnings of business are captured in asset value. Adjusted compensation is income paid to individual.
- Distinguish to avoid double-counting.

Example 2: Lots of Characteristics of 'Income'

Green Highlight to warn of double counting. These earnings are captured as earnings for asset value of the business and should not be double-counted for income determination.

Dr. B's Non-Passive Income	Ownership Interest	2019	2018	2017	2016	2015	2014
Operating Company - Income Share Earnings - BV	56.67%	$464,134	$473,749	$458,915	$237,718	$233,151	$107,712
Consulting Company - Earnings - No BV	50.00%	517,945	489,695	481,974	457,297	418,497	385,638
Eat What You Kill' - Earnings - No BV	20.00%	426,978	537,465	564,440	447,697	518,367	441,656
Directorship Earnings - No BV	100.00%	34,585	23,639	28,165	30,443	37,009	43,984
Other Earnings - No BV		0	0	0	0	0	6,750
Other Earnings - No BV			0	0	0	0	14,375
Expert Medical Witness 1099 income		0	0	0	1,138	0	0
Total		$1,443,642	$1,524,548	$1,533,494	$1,174,293	$1,207,024	$1,000,115
Less Operating Co Distributions - included in VALUATION		($464,134)	($473,749)	($458,915)	($237,718)	($233,151)	($107,712)
Adjusted Total Non-Passive Income		**$979,508**	**$1,050,799**	**$1,074,579**	**$936,575**	**$973,873**	**$892,403**

Dr. B's Passive Income							
Property 1 - Valued by Mercer Capital	10.00%	8,698	158,559	209,161	191,239	148,039	101,486
Property 2 - Valued by Mercer Capital	47.50%	52,150	136,516	92,586	69,557	0	0
Property 3 - Valued by Mercer Capital		0	504,562	0	0	0	0
Interest Income		13,794	16,060	5,464	1,708	761	1,095
Dividend Income		0	2,414	2,559	298	0	0
Total		$74,642	$818,111	$309,770	$262,802	$148,800	$102,581
Less Property 1 Distributions - included in Property 1 Valuation		($8,698)	($158,559)	($209,161)	($191,239)	($148,039)	($101,486)
Less Property 2 Distributions - included in Property 2 Valuation		($52,150)	($136,516)	($92,586)	($69,557)	$0	$0
Less Property 2 One-time Gain on Sale		-	($504,562)	-	-	-	-
Adjusted Total Passive Income		**$13,794**	**$18,474**	**$8,023**	**$2,006**	**$761**	**$1,095**

Total Income before adjustments for double-counting		$1,518,284	$2,342,659	$1,843,264	$1,437,095	$1,355,824	$1,102,696
Adjusted Total Income		$993,302	$1,069,273	$1,082,602	$938,581	$974,634	$893,498
	Difference	*$524,982*	*$1,273,386*	*$760,662*	*$498,514*	*$381,190*	*$209,198*

Concluding Thoughts

No case is just like the previous.

There is no one size fits all approach.

Statutes & Precedent differ.

Importance of understanding the correlation and implication(s) from the valuation onto the income/forensic elements.

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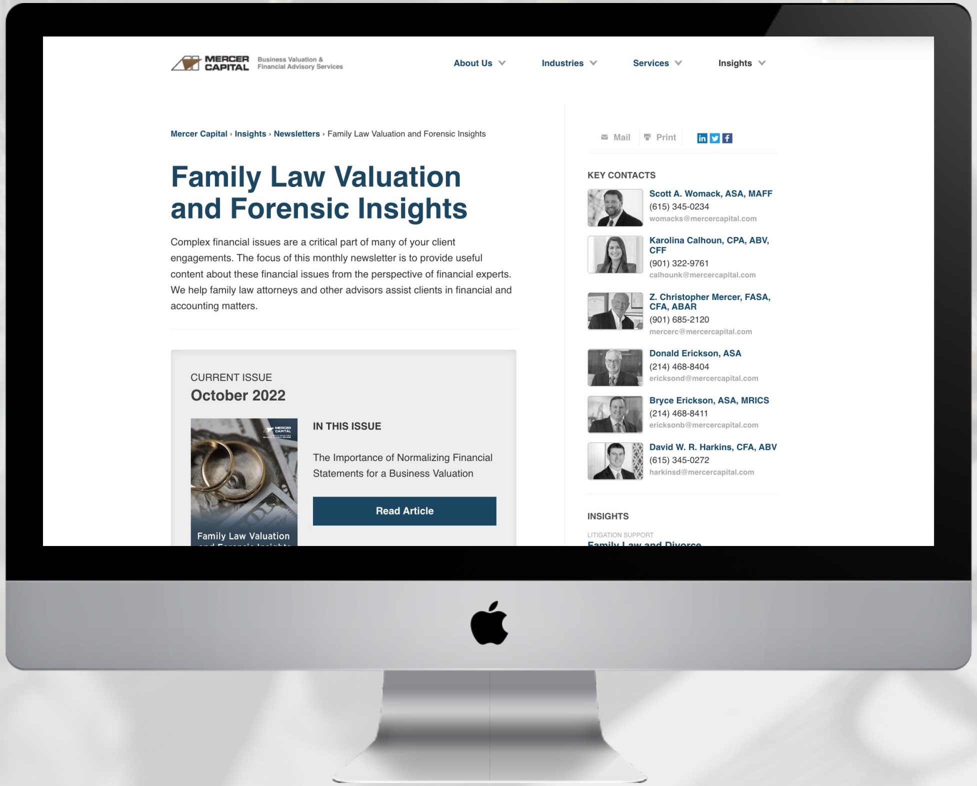
Family Law Valuation and Forensic Insights



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